**Fair Political Practices Commission**
**MEMORANDUM**

**To:** Chairman Getman, Commissioners Downey, Knox, Scott, and Swanson

**From:** Luisa Menchaca, General Counsel
Lawrence T. Woodlock, Senior Commission Counsel

**Subject:** Proposition 34 Regulations, Prenotice Discussion, Allocating Expenditures subject to Voluntary Expenditure Ceilings, Section 85400. (Proposed Regulation 18540)

**Date:** July 16, 2001

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## Introduction

Proposition 34 added to the Political Reform Act ("the Act") a system of Voluntary Expenditure Ceilings. Section 85400 establishes the amount of these ceilings for each of the elective state offices to which an expenditure ceiling is assigned. In campaigns for each office, Section 85400 prescribes one ceiling for primary (or special primary) elections, and a second limit for general, special, or special runoff elections. This memorandum describes proposed Regulation 18540, which would establish guidelines for allocating covered campaign expenditures between and among these elections. The first major question is which of two complimentary types of allocation rule the Commission prefers. In addition, staff proposes to include in the regulation a separate provision on non-monetary contributions, while a third proposed subsection would identify certain expenditures which do *not* count towards the limits prescribed by Section 85400.

In pre-notice discussion, the Commission need not consider or decide every question raised by Section 85400, and this memorandum does not recommend a decision now on every option identified as such in the proposed regulation. But guidance on the major decision points will facilitate a more focused discussion when the regulation comes back for adoption in October.

## The Statutory Scheme

Section 85400(a) provides that: "A candidate for elective state office, other than the Board of Administration of the Public Employees' Retirement System, who voluntarily accepts expenditure limits may not make campaign expenditures in excess of the following:…" The statute then specifies an expenditure limit for primary elections, and a second (higher) limit in

post-primary elections, for each of five elective state offices.[1] Because Section 85400 provides separate and distinct limits for every election for each office, to comply with the statute candidates who accept expenditure limits must be able to allocate expenditures to particular elections.

Subsection (b) of Section 85400 provides that: "For purposes of this section 'campaign expenditures' has the same meaning as 'election related activities' as defined in subparagraph (C) of paragraph (2) of subdivision (b) of Section 82015." Section 82015(b)(2)(C) reads as follows:

> "(C) for purposes of subparagraph (B), a payment is made for purposes related to a candidate's candidacy for elective office if all or a portion of the payment is used for election-related activities. For purposes of this subparagraph, 'election-related activities' shall include, but are not limited to, the following:
> (i) Communications that contain express advocacy of the nomination or election of the candidate or the defeat of his or her opponent.
> (ii) Communications that contain reference to the candidate's candidacy for elective office, the candidate's election campaign, or the candidate's or his or her opponent's qualifications for elective office. (iii) Solicitation of contributions to the candidate or to third persons for use in support of the candidate or in opposition to his or her opponent. (iv) Arranging, coordinating, developing, writing, distributing, preparing, or planning of any communication or activity described in clauses (i), (ii), or (iii), above.
> (v) Recruiting or coordinating campaign activities of campaign volunteers on behalf of the candidate.
> (vi) Preparing campaign budgets.
> (vii) Preparing campaign finance disclosure statements. (vii) Communic or her opponent."

This *non-exclusive* list of "election-related activities" forms the working definition of "campaign expenditures" under Section 85400. Staff did not think it possible or necessary to elaborate on the definition of "election-related activities" added as Section 82015(b)(2)(C) in 1997 (Stats 1997, ch. 450.) The continuing evolution of communications technology and the advertising industry, together with the inventiveness of campaign professionals, insures that there will always be novel expenditures requiring *ad hoc* analysis, defeating any attempt at an

[1] The statute separately treats races for the state Assembly, the Senate, for the Board of Equalization, for other statewide offices, and for the governorship.

exhaustive catalogue of expenditures subject to Section 85400. Experience with the Act's reporting requirements has, in any event, left the regulated community with a practical understanding of what constitutes a "campaign expenditure," with few notable exceptions.[2]

Section 85400 imposes one task unfamiliar to the regulated community, in requiring that campaign expenditures now be assigned to particular elections within a larger campaign (typically a primary and a general election). Accordingly, subdivision (a) of proposed Regulation 18540 articulates rules for allocating these expenditures between and among elections in a given campaign. Decision One offers the Commission a choice between (Option A) a provision that specifies an allocation rule for each common class of campaign expenditure, with a default rule for expenditures not enumerated, and (Option B) a general rule with a few specified exceptions.

**Decision One: Allocating Expenditures Between Elections**

Decision One concerns subsection (a) of the proposed regulation. Within this decision are two options – A and B – alternative methods of prescribing how particular expenditures will be allocated to particular elections, as required by Section 85400. Emergency Regulation 18542 states the manner in which candidates may indicate acceptance or rejection of the new ceilings.[3] The most pressing question that remains is how candidates who accept those limits must allocate their expenditures to the various elections. Staff strongly recommends that the Commission adopt some form of rule on this point. There are two choices, each of which includes sub-options.

**Option A** describes six different classes of campaign expenditures which, staff believes, include nearly all typical campaign expenditures. An allocation rule is provided for each class of expenditure. Subdivision (a)(7) then states a "catch-all" or "default" rule providing that expenditures not falling within one of the previously enumerated classes shall be allocated to the next election held on or after the date when the expenditure was made. Subdivision (a)(8) would obligate candidates to maintain records supporting their expenditure allocations. Finally, an optional subsection (b) would require that allocations under Section 85400 be reported on the campaign reports due on or after the date the expenditure is made.

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[2] The one common form of "campaign expenditure" that occasionally generates confusion is the "non-monetary" or "in-kind" contribution. The practice in California, as well as in the federal system and in virtually all states, is to regard non-monetary contributions as campaign "expenditures" made on the date of receipt. Decision Two offers the Commission an opportunity to expressly state this rule in the proposed regulation, to minimize reporting errors among persons not familiar with a practice that, while necessary, can appear counter-intuitive.

[3] Regulation 18542 will come before the Commission for permanent adoption at the October meeting, when the Commission will also be considering adoption of Regulation 18540.

Option A is modeled on a corresponding federal regulation (11 CFR Section 100.8), adapted to reflect the kinds of expenditures commonly reported as campaign expenditures in California. It is designed to assist the reader in identifying the rule applicable to coherent classes of campaign expenditures. The importance of tailoring allocation rules to classes of expenditure is illustrated throughout the proposed regulation. The proposed default rule would attribute expenditures to the election immediately following the point at which the expenditure is made. But that rule would inappropriately allocate to a primary election large sums of money spent early in the campaign to reserve television time for an advertising blitz on the eve of the *general* election. In subdivision (a)(2) the date of publication or distribution of such advertisements determines the election to which the expenditure will be allocated.[4] Fundraising is another common example of expenditures often made far in advance of the election which they are intended to influence. Under subdivision (a)(6), fundraising costs are allocated wherever possible to the election for which the funds are raised.

In other expenditure classes it is less common to spend large sums of money during one pre-election period for goods or services disseminated in another election. This is typically the case with telephone banks, professional services, and overhead expenses, for example.[5] (See subdivisions (a)(3), (a)(4) and (a)(5).)

Option A(3) would add a recordkeeping requirement important – for both prosecution and defense – when a candidate's allocation decisions are challenged in an enforcement action. The federal rule on which Option A is modeled contains a similar recordkeeping requirement. Staff recommends that the Commission include this option if it adopts Option A. Finally, Option A(4) directs the reader to Emergency Regulation 18421.4(b), which prescribes the manner in which allocations under Section 85400 shall be reported.[6]

If the Commission prefers the approach taken in Option A, its remaining decisions will be focused on the details of language throughout and, in particular, on whether to accept, reject, or modify the language marked off by brackets as options within the larger rule. These questions can, of course, be raised and resolved at the pre-notice discussion if they are pertinent to the

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[4] Option A(1) adds to subdivision (a)(2) a rule governing refunds of broadcast time or advertising space purchased but not used. This rule allocates such refunds to the election to which the payment would otherwise have been allocated. Staff recommends adoption of this rule, if the Commission prefers Option A, to insure that defeat in a primary, resulting in a refund, would not also result in an inadvertent *post-hoc* violation of the primary expenditure limit.

[5] An optional exception is provided to the general rule for professional services, to cover instances where a contract expressly allocates fees and costs to particular elections. In such cases, this option would provide that the terms of the contract determine how the expenditures will be allocated. This option offers a way to track delivery of services more accurately, especially in contracts which obligate the candidate for the entire contract payment on the date the contract is signed, which require large pre-payments or, conversely, which defer payment obligations to a later date. On the other hand, it is possible that this option would permit "gaming" of the rules, transferring to the parties a degree of control that would encourage grossly unrealistic expenditure allocations.

[6] Regulation 18421.4, like all emergency regulations pertinent to proposed Regulation 18540, will come before the Commission for permanent adoption in October, when Regulation 18540 will also be up for adoption.

Commission's choice as between Option A and Option B.

**Option B** is an alternative approach to assisting the regulated community in allocating campaign expenditures under Section 85400. It states a general rule equivalent to the "catch-all" provision of Option A, at subdivision (a)(7). Option B(1) is a recordkeeping requirement similar to Option A(3). Staff regards such a recordkeeping requirement as vital to the just adjudication of claims relating to compliance with the expenditure ceilings of Section 85400.

The advantage of Option B lies in the brevity of a general rule. Brevity is also a substantial disadvantage insofar as a "one size fits all" rule would result in occasional mis-allocation of substantial campaign expenditures. Unless exceptions are provided, a candidate in a safe primary could devote the bulk of his "primary" expenditures to the purchase of television or other advertising materials broadcast and disseminated during the final weeks of the *general* election. Option B(2) would avoid such predictable misallocations by grafting onto the general rule an exception for expenditures on broadcast, print or electronic media, like the rule proposed at subdivision (2) under Option A. If Option B(2) is adopted, Option B(3), the equivalent of Option A(1) should considered, if the Commission believes that refunds of advertising payments should be allocated to the election the funds were originally spent to influence.

Option B(4) repeats the general rule in the context of expenditures on professional services, and is therefore unnecessary unless the Commission wishes to adopt Option B(5) which, like subdivision (a)(4) under Option A, provides a different rule when such expenditures are allocated by contract, or when the contract provides for a bonus payment contingent on the outcome of a particular election. Options B(6) and B(7) allocate fundraising expenditures to the election for which the funds were raised, when possible, and exempts from Section 85400 expenditures incurred in raising funds to pay off old debt under the provisions of Section 85316.

Finally, Option B(8) would add an additional subsection to direct the reader to new Regulation 18421.4(b), which prescribes the manner in which allocations under Section 85400 shall be reported.

If the Commission prefers Option B, staff recommends that it adopt Option B(1) to insure that the candidate maintains records supporting his or her allocations under Section 85400. Staff also recommends the adoption of Options B(2) through B(7), adding a subsection (b) to this regulation. This would avoid some inevitable, and substantial, misallocations, albeit at considerable cost to brevity.

Recognizing that utmost brevity and refined allocation rules cannot be achieved simultaneously in an area as diverse as campaign expenditures, staff regards Option A as the better choice overall. Option B can be tailored as well as Option A, but not without adding to its length and complexity. As between two regulations of roughly equal length, Option A is easier to follow, and provides guidance for every common class of expenditure. Experience has taught that a rule in this format reduces the number of questions from perplexed campaign treasurers.

On the other hand, a similar claim is advanced for Option B; if the Commission were to adopt it without any "tailoring" provisions, Option B would provide a clear, "bright line" rule. But that clarity would be achieved at the cost of substantial misallocations of campaign expenditures.

**Decision Two: Non-Monetary Contributions**

Sections 85400 and 82015(b)(2)(C) do not consider the *form* that expenditures may take, and so have nothing to say about the "in-kind" or "non-monetary" contribution. Candidates with reporting obligations under the Act currently report non-monetary contributions as "expenditures" on the summary page of their Forms 460, and the treatment of non-monetary contributions as the functional equivalent of "expenditures" is well established under the Act. Jurisdictions with expenditure ceilings (now including California) have a particular interest in characterizing "non-monetary contributions" as "expenditures," both for accurate accounting, and to discourage evasion of expenditure limits by replacement of monetary with non-monetary contributions. Regulation 18540(b) follows many local California jurisdictions in expressly stating that non-monetary contributions will count as "expenditures" subject to expenditure limits.[7]

Attendees at the May 30 Interested Persons Meeting agreed that non-monetary contributions would count as "expenditures" under Section 85400, but suggested an important qualification. While there is no doubt that non-monetary expenditures *can* be the functional equivalent of campaign expenditures subject to the limits of Section 85400, the interested persons believe that the Commission should specify in this regulation that these "contributions" are subject to Section 85400 *only* when an equivalent (monetary) expenditure would have been a "campaign expenditure" within the meaning of Section 85400. The point is well taken.

The fundamental reason for including in this regulation an express provision relating to non-monetary contributions is notice to persons who may not be familiar with the nature and use of non-monetary contributions who, misled by terminology, may not grasp their real-world equivalence with campaign expenditures. "Contribution" and "expenditure" are normally viewed as opposites, like "giving" and "receiving." This distinction is satisfactory, however, only when the contribution comes in the form of money. An example will illustrate the peculiar features of non-monetary contributions, which are not always understood by the public.

If a contributor provided a check for $1,000 to a campaign on Monday, that check could be deposited in the campaign bank account and recorded the same day as a contribution. On Tuesday, the treasurer could make out a $1,000 check on the same account, to pay for a quantity of campaign mailers, whereupon the treasurer would enter a $1,000 expenditure on the books. Contribution and expenditure are duly recorded, and the expenditure would count against an

[7] For example, Long Beach, Los Angeles and San Francisco have, or have had, ordinances defining "Qualified Campaign Expenditures" to include "A non-monetary contribution provided at the request of or with the approval of the candidate, officeholder or [committees variously identified]."

expenditure ceiling. To prevent evasion of expenditure ceilings, the result must be the same when the contributor takes his check on Monday to the printer and purchases the campaign mailers himself, delivering the mailers to the campaign on Tuesday as a non-monetary contribution. To insure that the consequences are the same regardless of *who* purchases the mailers, the non-

monetary contribution is treated as both contribution *and* expenditure. Although it is the *contributor* who makes the expenditure, he does so on behalf of the campaign.

If the contribution of $1,000 worth of mailers did not count against campaign expenditure limits, jurisdictions employing such limits would find that, instead of moderating the costs of political campaigns, expenditure limits would inevitably cause a migration away from monetary contributions in favor of less readily documented transactions that would allow the costs of campaigns to soar beyond the statutory limits. This, in a nutshell, is why jurisdictions with expenditure ceilings characterize non-monetary contributions as *de facto* expenditures.

The question before the Commission is whether the regulation should expressly treat non-monetary contributions. The functional equivalence of "contribution" and "expenditure" in this context is understood by most experienced campaign treasurers, but staff recommends that the Commission follow the example of other jurisdictions in making this treatment explicit. The proposed wording of subsection (b) further advises the interested public that not all such contributions constitute "campaign expenditures," and offers some guidance in valuing non-monetary contributions when they are recorded as campaign expenditures.

The argument against including subsection (b) is that it is unnecessary, particularly since candidates subject to Section 85400 (those running for the state legislature and higher offices) are said to be reasonably sophisticated candidates who understand the treatment of non-monetary contributions as "expenditures."

**Decision Three: Listing Expenditures That Do Not Count Against the Limits**

In Decision Three, the Commission will consider the utility of proposed subsection (c), which identifies certain expenditures that will not be subject to the voluntary expenditure ceilings of Section 85400. In all but one case, the "exceptions" listed in this subdivision are based on provisions of the Act or existing regulations. It is staff's experience, however, that the public is often uncertain how to characterize or report these expenditures, and staff anticipates a large number of questions that could be answered by this brief provision.

The one "exception" not based on existing law is that for preparing campaign reports. Currently, Section 82015(b)(2)(C) expressly describes such expenditures as "election related activities" at subd. (vii), quoted above at page 2. Section 85400 incorporates these "election related activities" into its definition of "campaign expenditures," as explained earlier. It would

therefore be contrary to the existing statutes to create an exception for campaign reporting expenditures, effectively removing the reference to Section 82015(b)(2)(C)(vii) from Section 85400. However, the current version of SB 34, which has now traveled some distance through the legislative process, would amend Section 85400 to accomplish that very object, amending Section 85400(b) to read as follows:

> "(b) For purposes of this section, "campaign expenditures" has the same meaning as "election-related activities" as defined in clauses (i) to (vi), inclusive, and clause (viii) of subparagraph (C) of paragraph (2) of subdivision (b) of section 82015."

If SB 34 is enacted in its current form, it will plainly be the intent of the Legislature that expenditures associated with "Preparing campaign finance disclosure statements" be exempted from the limits of Section 85400. Staff has added to the proposed regulation language reflecting the Legislature's manifest intent in SB 34, and recommends that the Commission reserve decision on this question until the regulation comes up for adoption at the October meeting, when the fate of the bill should be known.

With or without the exception for campaign reporting expenses, staff recommends approval of subsection (c).